ECO550 Week 10 Scenario Script: Long-term Investment Analysis

Slide # Topic Narration

Slide 1 Scene 1

An older cottage style family run business (Katrina’s Candies)

Slide 2 Scene 2

Ken, Gigi, Renee, Maria and Herb meet in the conference room. Ken reminds the team that the meeting is to hear results of Herb’s research Ken: Good afternoon everyone.

Gigi: Good afternoon Ken!

Renee: Hello everyone.

Maria: Hi Ken.

Herb: Good afternoon everyone.

Ken: Today we are meeting so Herb can present his recommendation regarding the Board’s directive to expand the global presence of Katrina’s Candies. Herb’s recommendation culminates nine weeks of exhausting work by each of you. I know each of you worked hard on this special project because at the same time you were also maintaining your daily responsibilities. I want to give a special thanks to each of you!

Gigi: Thanks!

Renee: Thank you, Ken!

Herb: It was our pleasure!

Maria: Thanks, Ken!

Ken: You are all very welcome! Now as you know, Herb has been working with us part-time for the past nine weeks because he’s finishing his last four MBA courses at Strayer University’s Global Campus. During the nine-weeks, each of you supported Herb on this special project! Each of you also communicated in one way or another how very satisfied and happy you are to have Herb here. So, before Herb share’s his findings, let’s give him a hand!

(Add clapping from Ken)

The floor is now yours, Herb!

Slide 3 Scene 3

Everyone is still in the conference room and Herb is beginning his presentation.

Show projector screen showing “Determine the feasibility of expanding Katrina’s Candies global markets.”

Show projector screen showing “Planning Period information.”

Show projector screen showing “Demand Function #1.”

Herb: Thank you, Ken, for the flattering introduction. I also want to thank the team for supporting me on this special project, Gigi, Renee, and Maria; I would not have made any progress on the project without your assistance.

Gigi: It was our pleasure working with you, Herb!

Herb: Let’s begin and start with how we have arrived at this point. I was first assigned the task of preparing an analysis of the Board’s proposal to expand the global component of Katrina’s Candies.

Herb: First, My team and I met to create a plan of action. During this meeting we discussed and formulated a plan of action and assigned tasks. We also scheduled times for me to meet with each team member to implement specific tasks like creating a model as well as reviewing and discussing data.

Herb: One of our first tasks was to formulate a useful model of demand for Katrina’s Candies Sugar-free chocolates and use the model to derive elasticity coefficients. Renee and I worked on this task. We started with a standard model of demand. The independent variables for this function were as follows:

The per unit price of Katrina’s Sugar Free Chocolate;

The price of a substitute good which was caffeinated coffee;

The price of a complementary good;

Income; and

The number of buyers.

Of course, the quantity of Katrina’s Candies Sugar Free Chocolate candy was the dependent variable. Keep in mind that the estimated version of this model did not produce expected results. According to t-tests, caffeinated coffee was not a substitute for chocolate. Our results also revealed the presence of multi-collinearity between water and income. Because of both these issues, Renee and I decided to drop coffee and water from the model along with the number of buyers. In the revised version of the model we included a dummy variable to capture the affect of sales in international markets.

Slide 4 Scene 4

Everyone is still in the conference room and Herb is continuing his presentation.

Show projector screen showing “Demand Function Revised.”

Show projector screen showing “Contribution Margin Concept.” Herb: Here’s the estimated demand function and Katrina’s demand curve.

The revised demand model performed better, coefficients were significant--including the coefficient on the dummy variable representing Katrina’s Candies global operations. The coefficient was positive which means the sale of the sugar free chocolates in international markets has contributed to Katrina’s Candies revenue.

Herb: Next, Renee and I reviewed cost concepts to identify the concept most relevant to the Board’s proposed action to expand your global market. After evaluating both the average total cost approach and the contribution margin approach, we decided the contribution margin concept provides the information most relevant for our purposes. Keep in mind that the Contribution Margin is the most relevant cost measure because it gives information about the impact expansion decisions have on fixed costs. We then used the coefficients from the demand curve model to derive the price elasticity of demand for your sugar free chocolates. We can also use the contribution margin model to determine how much we need to produce to break-even in new markets.

Slide 5 Scene 5

Everyone is still in the conference room and Herb is continuing his presentation.

Show projector screen showing “Katrina’s Candies – Business Profile.”

Herb: We then had to come up with a business profile for Katrina’s Candies and here is what we recorded:

We learned that Katrina’s Candies is an oligopoly.

We saw that the three largest firms in Katrina’s Candies market have a combined forty percent share of the chocolate candy market.

We noted the mutual interdependence that characterizes oligopolistic markets means the three largest firms will react to its expansion decision.

We noticed that the reactions of Katrina’s competitors will not include price changes because oligopolists avoid price competition.

Slide 6 Scene 6

Everyone is still in the conference room and Herb is continuing his presentation.

Show projector screen showing “Option 1 for Katrina’s Candies.”

Herb: As we were reflecting on the meaning of the information we gathered, Ken’s interest in merging Katrina’s Candies with the largest Mexican manufacturer, La Chocolata, gave the team another possible way to expand.

Herb: One of Katrina’s Candies options is to expand its Global Presence through a merger with LaChocolata. A merger would be categorized as a horizontal merger since both firms manufacture a final good. We would, however, need approval from the U.S. federal government and Katrina’s Candies Stockholders’ approval. According to the internal analysis conducted in relation to the Board’s proposed action, the merger would also enhance Katrina’s Candies revenue. Also the income coefficient generated for its demand function indicates the Sugar Free Chocolate should sell well in the lower income markets. One of the risks with using this option would be a loss of Katrina’s Candies identity as a small family owned business. That is something to keep in mind as well.

Slide 7 Scene 7

Everyone is still in the conference room and Herb is continuing his presentation.

Show projector screen showing “Option 2 for Katrina’s Candies.”

Herb: Another option for Katrina’s Candies is to expand through Capital Investment. Using this option Katrina’s Candies would add an annex devoted solely to manufacturer and export of its Sugar-Free Chocolate. Stockholder and government approval would not be required. Keep in mind that there are also U.S. and European Union initiatives that encourage and support the export of goods and services. These initiatives also provide support services that reduce fixed costs related to an export expansion. The risk associated with the investment option is the possibility of over-expansion and the uncertainty associated with world-wide business cycles.

Herb: I covered a lot of material during this presentation and would like for you to go over some review materials I have put together. I believe these review materials will really solidify everything I have discussed today.

Slide 8 Scene 8

Interaction Slide

Will Review Key Concepts Discussed

Create a interactive interface that contains links to the following resources (Items will be played from within Scenario via embedding)

• Cost Analysis

o http://www.youtube.com/watch?v=SUberLlz0Us

• How to take charge and plan for the future of your business.

o http://www.youtube.com/watch?v=7C\_z8UuCJ-Y

Slide 9 Scene 9

Check Your Understanding #1

Multiple Choice

A firm produces and sells a product with price, P = $16, average variable cost, AVC = $12 and total fixed cost, TFC = $60,000. What is the level of output at which the firm will break-even.

a. 7,500

b.10,000

c.15,000

b.17,500

Answers for CYU

a. Incorrect. Try again; did you set the equation properly?

b. Incorrect. Try again; did you set the equation properly?

c. Correct. Yes, given the contribution margin this level of output will yield a break-even for the firm.

d. Incorrect. Try again; did you set the equation properly?

Slide 10 Scene 10

Check Your Understanding #2

Herb-1: When Herb informed the team Katrina’s Candies could implement the Board’s directive by engaging “capital investment,” what Herb meant is Katrina’s Candies should contact their firm’s investment banker to acquire financial assets. Do you agree or disagree?

Herb-2-Agree: This is an incorrect response. Keep in mind that while Katrina’s Candies financial asset portfolio would change if it issued new stock. Herb meant Katrina’s Candies should allocate money to the task of acquiring more capital--a new physical building and new equipment and materials.

Herb-3-Disagree: You are correct! Herb was not referring to financial assets. Instead, Herb meant Katrina’s Candies would need to allocate more money to the task of acquiring more capital--a new physical building and new equipment and materials. If Ken and the Board choose capital investment as the firm’s strategy, then the question of financing would arise.

Slide 11 Scene 11

Summary slide

Takes place in the conference room and recaps the lesson’s main points. Herb: This concludes my presentation. Does anyone have any questions?

Ken: Thank you, Herb. That was a very comprehensive report and I’m glad you incorporated some review activities. These will really help out the Board with things they may not fully grasp. This presentation was quite informative and will really assist me when I meet with the Board. Before I tell you my thoughts, does anyone have a question or comment?

Gigi: I think I can speak for the team when I say Herb’s report was outstanding. When we worked with him individually, we could not see fully where we were headed. Today’s presentation really brought all of our individual efforts into focus.

Maria: I concur! Great job, Herb!

Renee: Ditto, Herb! Fantastic job!

Gigi: Herb, based on your research and report, which option do you recommend Katrina’s Candies should implement?

Herb: Thanks for your question, Gigi. When I started my report, my full intent was to recommend a specific action; however, by the time I arrived at the recommendations section of the report I had changed my mind. I believe that since this is a family business the final decision should be made by Ken.

Ken: Herb, I appreciate your sensitivity to this situation. The Board’s directive has really challenged me! Today your presentation re-invigorated me and provided me with final information I need to respond to the Board. Unfortunately, I cannot share my decision with the team before presenting it to the Board. However, I will ask for special permission for the team to attend the Board meeting so you can receive my response at the same time I provide it to the Board.

Herb: That sounds great, Ken!

Ken: There is one more thing I would like to discuss before I meet with the Board. Herb, you have done a fabulous job while working for us here at Katrina’s Candies. I would like to speak on behalf of everyone here and offer you a full time position when you graduate from your MBA program. What do you say?

Herb: My answer is yes without any hesitation! I would love to continue to be a part of Katrina’s Candies team and am delighted you have offered me a position!

Ken: That is great, Herb! When you are close to graduating contact me and we will gladly have you back with open arms.

Gigi: Congratulations, Herb! You deserve it!

Maria: Good work, Herb!

Renee: Can’t wait to continue working together with you once you complete your graduate studies!

Herb: Thank you all for this opportunity and I will see you all in a couple of months after graduation. Take care everyone and don’t forget to complete your weekly threaded discussions based on the key concepts we covered this week.!